AMENDED IN ASSEMBLY AUGUST 24, 2006

SENATE BILL No. 1136

Introduced by Committee on Budget and Fiscal Review

January 10, 2006

~~An act relating to the Budget Act of 2006.~~ *An act to amend Sections 5921, 5922, 5924, 12330, 16731, 16782, and 16784 of, and to add Section 5921.5 to, the Government Code, relating to state bonds, and declaring the urgency thereof, to take effect immediately.*

LEGISLATIVE COUNSEL'S DIGEST

SB 1136, as amended, Committee on Budget and Fiscal Review. ~~Budget Act of 2006.~~ *State bonds: financing and hedging contracts.*

(1) Existing law sets forth the duties and authority of the Treasurer generally in the sale of state bonds.

Existing law authorizes state government to enter into certain kinds of financing and hedging contracts in connection with, or incidental to, the issuance or carrying of bonds. Moneys are continuously appropriated from the General Fund in an annual amount necessary to pay all obligations, including principal, interest, fees, costs, indemnities, and all other amounts incurred by the state under or in connection with any credit enhancement or liquidity agreement entered into by the state as specified, for bonds payable pursuant to an appropriation from the General Fund.

This bill would specify that in addition to any other authorization provided by law, the Treasurer may enter into and manage on behalf of the state specified financing and hedging contracts with respect to any state bonds for which the Treasurer acts as the agent for sale.

(2) The State General Obligation Bond Law generally provides for a procedure that may be adopted by other acts, with any necessary

modifications, in authorizing the issuance and sale of state general obligation bonds and providing for the repayment of those bonds, including the determination of interest rates the bonds shall bear.

This bill would, for bonds approved by the voters after January 1, 2006, provide that payment of any amounts owed by the state to a counterparty pursuant to any interest rate hedging agreement entered into by the state, after any offset for payments owed to the state as specified, would be deemed to be included within the appropriation for interest on the bonds contained in the applicable bond act, subject to the limitations on interest rates set forth in the provisions of law described above and other specified conditions.

(3) The Treasurer is required to annually prepare a debt affordability report, to be presented to the Governor and the Legislature, to include specified components.

This bill would additionally require the report to include a description of the percentage of the state's outstanding general obligation bonds constituting fixed rate bonds, variable rate bonds, bonds that have an effective fixed interest rate through a hedging contract, and bonds that have an effective variable interest rate through a hedging contract, subject to specified criteria.

(4) This bill would declare that it is to take effect immediately as an urgency statute.

~~This bill would express the intent of the Legislature to enact statutory changes relating to the Budget Act of 2006.~~

Vote: ~~majority~~ *2/3*. Appropriation: no. Fiscal committee: ~~no~~ *yes*. State-mandated local program: no.

The people of the State of California do enact as follows:

~~SECTION 1. It is the intent of the Legislature to enact statutory changes relating to the Budget Act of 2006.~~

SECTION 1. Section 5921 of the Government Code is amended to read:

5921. As used in this chapter, the following definitions apply, unless the context otherwise indicates or requires another or different meaning or intent:

(a) "Bonds" mean bonds, notes, bond anticipation notes, commercial paper, or other evidences of indebtedness, or reimbursement warrants or refunding warrants, or lease, installment purchase, or other agreements or certificates of participation therein.

(b) ~~"State or local government"~~ *"State"* means the state~~,~~ *or* any department, agency, board, commission, or authority of the ~~state, or~~ *state.*

(c) "Local government" means any city, city and county, county, public district, public corporation, authority, agency, board, commission, or other public entity.

SEC. 2. Section 5921.5 is added to the Government Code, to read:

5921.5. For purposes of this chapter, in addition to any other authorization provided by law, the Treasurer may enter into and manage on behalf of the state any contracts described in Section 5922 with respect to any state bonds for which the Treasurer acts as the agent for sale pursuant to Chapter 9 (commencing with Section 5700).

SEC. 3. Section 5922 of the Government Code is amended to read:

5922. Notwithstanding any other provision of law, all of the following apply:

(a) *(1)* In connection with, or incidental to, the issuance or carrying of bonds, or acquisition or carrying of any investment or program of investment, ~~any~~ *the* state or *any* local government may enter into any contracts ~~which~~ *that* the state or local government determines to be necessary or appropriate to place the obligation or investment of the state or local government, as represented by the bonds, investment or program of investment and the contract or contracts, in whole or in part, on the interest rate, currency, cash-flow, or other basis desired by the state or local government, including, without limitation, contracts commonly known as interest rate swap agreements, currency swap agreements, forward payment conversion agreements, futures, or contracts providing for payments based on levels of, or changes in, interest rates, currency exchange rates, stock or other indices, or contracts to exchange cash flows or a series of payments, or contracts, including, without limitation, interest rate floors or caps, options, puts or calls to hedge payment, currency, rate, spread, or similar exposure. These contracts or arrangements may also be entered into by *the* state or *by* local governments in connection with, or incidental to, entering into or maintaining any agreement ~~which~~ *that* secures bonds, including bonds issued by private entities. These contracts and arrangements shall be entered into with the parties, selected by the means, and contain the payment, security, default, remedy, and other terms and conditions, determined by the state or *the* local government, after giving due consideration for the creditworthiness of the counterparties, where applicable, including any rating by a nationally recognized rating agency or any other criteria as may be appropriate.

~~No~~

(2) No local government shall enter into any of the contracts or arrangements pursuant to this subdivision, unless its governing body first determines that the contract or arrangement or program of contracts is designed to reduce the amount or duration of payment, currency, rate, spread, or similar risk or result in a lower cost of borrowing when used in combination with the issuance of bonds or enhance the relationship between risk and return with respect to the investment or program of investment in connection with, or incident to, the contract or arrangement which is to be entered into.

(b) Bonds issued by ~~a~~ *the* state or *by a* local government may be payable in accordance with their terms, in whole or in part, in currency other than lawful money of the United States of America, provided that the state or *the* local government ~~enter~~ *enters* into a currency swap or similar agreement for payments in lawful money of the United States of America, which covers the entire amount of the debt service payment obligation of the state or *the* local government with respect to the bonds payable in other currency, and provided further that if the term of that agreement is less than the term of the bonds, the state or *the* local government shall covenant to enter into additional agreements as may be necessary to cover the entire amount of the debt service payment obligation. An issuer shall include in its written notice to the California Debt Advisory Commission pursuant to subdivision (g) of Section 8855 a statement of its intent to issue bonds payable in a currency other than lawful money of the United States of America.

(c) In connection with, or incidental to, the issuance or carrying of bonds, or entering into any of the contracts or arrangements referred to in subdivision (a), the state or *a* local government may enter into credit enhancement or liquidity agreements, with payment, interest rate, currency, security, default, remedy, and other terms and conditions as the state or *the* local government determines.

(d) Proceeds of bonds and any moneys set aside and pledged to secure payment of the bonds or any of the contracts entered into pursuant to this section, may be invested in securities or obligations described in the ordinance, resolution, indenture, agreement, or other instrument providing for the issuance of the bonds or the contract and may be pledged to and used to service any of the contracts or agreements entered into pursuant to this section.

SEC. 4. Section 5924 of the Government Code is amended to read:

5924. (a) Notwithstanding Section 13340, there is hereby continuously appropriated without regard to fiscal years, from the General Fund in the State Treasury for the purpose of this chapter, an amount that will equal the sum annually as will be necessary to pay all obligations, including principal, interest, fees, costs, indemnities, and all other amounts incurred by the state under or in connection with any credit enhancement or liquidity agreement (including in the form of a letter of credit, standby purchase agreement, reimbursement agreement, liquidity facility, or other similar arrangement) entered into by the state pursuant to this chapter for bonds payable pursuant to an appropriation from the General Fund.

(b) Fees, costs, and other similar expenses may be incurred by the state under or in connection with any credit enhancement or liquidity agreement entered into by the state pursuant to this chapter if the agent for sale determines that the credit enhancement or liquidity agreement is expected to result in a lower cost of the borrowing for the bonds to which the credit enhancement or liquidity agreement pertains. The amount appropriated pursuant to ~~this section~~ *subdivision (a)* for fees, costs, and other similar expenses incurred in connection with any credit enhancement or liquidity agreement, when expressed as a percentage of the original principal amount of the bonds to which the credit enhancement or liquidity agreement pertains, may not exceed the percentage set forth in paragraph (1) of subsection (g) of Section 147 of Title 26 of the United States Code enacted as of

January 1, 2003. The amount appropriated pursuant to ~~this section~~ *subdivision (a)* for interest incurred in connection with any credit enhancement or liquidity agreement, when expressed as a percentage of the outstanding principal amount of the bonds to which the credit enhancement or liquidity agreement pertains, may not exceed the interest rate percentage set forth in subdivision (d) of Section 16731.

SEC. 5. Section 12330 of the Government Code is amended to read:

12330. (a) At the request of either house of the Legislature, or of any committee thereof, the Treasurer shall give written information as to the condition of the State Treasury, or upon any subject relating to the duties of his or her office.

(b) The Treasurer annually shall prepare a debt affordability report, to be presented to the Governor and the Legislature by October 1 of each year.

(1) The report is intended to be a framework for the Legislature to evaluate and establish priorities for bills that propose the authorization of additional state debt supported by the General Fund, excluding self-liquidating general obligation debt, during the budget year. The report may also be used to determine the amount to appropriate for debt service for the budget year.

(2) The report shall include the following information:

(A) A listing of authorized but unissued debt that the Treasurer intends to sell during the current year and the budget year and the projected increase in debt service as a result of those sales.

(B) A description of the market for state bonds.

(C) An analysis of the ratings of state bonds.

(D) A listing of outstanding debt supported by the General Fund.

(E) A listing of authorized but unissued debt that would be supported by the General Fund.

(F) A schedule of debt service requirements for the items included in subparagraph (D).

(G) Identification of pertinent debt ratios, such as debt service to General Fund revenues, debt to personal income, debt to estimated full-value of property, and debt per capita.

(H) A comparison of the debt ratios prepared for subparagraph (G) with the comparable debt ratios for the 10 most populous states.

(I) A description of the percentage of the state's outstanding general obligation bonds constituting fixed rate bonds, variable rate bonds, bonds that have an effective fixed interest rate through a hedging contract, and bonds that have an effective variable interest rate through a hedging contract. The report shall also include, for each outstanding hedging contract, a description of the hedging contract, the outstanding notional amount, the effective date, the expiration date, the name and ratings of the counterparty, the rate or floating index paid by the state and the rate or floating index paid by the counterparty, and a summary of the performance of the state's hedging contracts in comparison to the objectives for which the hedging contracts were executed.

SEC. 6. Section 16731 of the Government Code is amended to read:

16731. Whenever the committee determines that the sale of all or any part of the bonds authorized to be issued is necessary or desirable, it shall adopt a resolution to that effect. The resolution shall specify the following as to the bonds then to be sold:

(a) The aggregate number, aggregate par value, denominations, and the date of the bonds to be then sold. The denominations shall be in the sum of one thousand dollars ($1,000) or multiples of that sum. The date appearing on the bonds shall be deemed to be the date of issuance for all purposes of this chapter, irrespective of the actual date of delivery of the bonds and the payment of the purchase price of the bonds.

(b) The dates of maturity and the amount of the bonds maturing at each date of maturity, which amounts need not be equal. The last dates of maturity shall be not more than 45 years after the date of the bonds.

(c) Whether or not the bonds are to be subject to redemption or tender prior to maturity, and, if so, the provisions for the redemption or tender, the manner of the call or notice thereof, and the price or prices at which the bonds shall be subject to redemption or tender.

(d) *(1)* The annual rate, or rates, of interest that the bonds to be issued shall bear, which may be in multiples of one-eighth or one-twentieth of 1 percent, but not in excess of 11 percent. The rate or rates may be determined at the time of the sale of the bonds. Alternatively, the resolution may specify that the bonds may pay a variable interest rate, as prescribed in the resolution. However, at the time and as the result of the issuance of any bonds bearing a variable interest rate, the aggregate principal amount of all state general obligation bonds bearing variable interest rates may not exceed 20 percent of the aggregate principal amount of all state general obligation bonds then outstanding. For purposes of this calculation, variable rate bonds shall not include bonds issued pursuant to Section 16731.6 or bonds that have an effective fixed interest rate through a hedging contract*, but shall include bonds that have an effective variable interest rate through a hedging contract*. Notwithstanding any other provision of this chapter, if the committee decides to issue state general obligation bonds bearing variable interest rates, the committee is not required to comply with Section 16732. Notwithstanding any other provision of law, if bonds are issued bearing a variable interest rate under a bond act approved by the voters prior to January 1, 2002, and if the variable interest rate bonds provide a right of tender, then any amount payable by the state as a result of the tender with respect to principal of and interest on the bonds prior to the regularly scheduled principal or interest payment dates, or payable by the state pursuant to redemption or call initiated as a means to repay the obligation of the state resulting from the tender, is not backed by the full faith and credit of the state and shall not be payable under the bond act. Further, no contractual obligation of the state under a standby bond purchase agreement or other liquidity facility entered into in connection with variable interest rate bonds providing a right of tender and issued under a bond act approved by the voters prior to January 1, 2002, shall be backed by the full faith and credit of the state and shall not be payable under the bond act. These obligations are subject to annual appropriation by the Legislature.

(2) (A) Notwithstanding any other provision of law, for bonds approved by the voters after January 1, 2006, payment of interest on the bonds as provided in this subdivision shall include

payment of any amounts owed by the state to a counterparty after any offset for payments owed to the state on any hedging contract described in Section 5922 in connection with those bonds, and those payments shall be deemed to be included within the appropriation for interest on the bonds contained in the applicable bond act. The total payments of stated interest on the bonds together with payments owed by the state after any offset for payments owed to the state on a hedging contract shall not exceed the maximum rate set forth in this subdivision.

(B) The Treasurer may not enter into any hedging contract described by subparagraph (A) unless the committee has approved policies developed by the Treasurer relating to the entering into and managing of those hedging contracts. The policies shall require that any hedging contract or program of contracts is designed to reduce the amount or duration of payment, currency, rate, spread, or similar risk or result in a lower cost of borrowing when used in combination with the issuance or carrying of bonds. The policies shall also include a description of the criteria to be used to evaluate the potential risks and benefits to the state of entering into a particular hedging contract or program of contracts and to evaluate the performance of outstanding hedging contracts in comparison to the objectives for which the hedging contract was executed. The policies approved pursuant to this paragraph are exempt from the requirements of Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3.

(e) The interest payment dates.

(f) The technical form and language of the bonds.

(g) Whether or not the right is reserved to make delivery in the form of temporary or interim bonds, certificates, or receipts, exchangeable for definitive bonds when executed and available for delivery. If the right is reserved, the denominations and form of the temporary securities shall be stated.

(h) Provisions for the registration and exchange of bonds and for the use of a depository to hold book-entry bonds after issuance.

(i) All other terms and conditions of the bonds and of the execution, issuance, and sale of the bonds, which shall be consistent with all of this chapter.

SEC. 7. Section 16782 of the Government Code is amended to read:

16782. (a) Refunding bonds may be issued in a principal amount sufficient to provide funds, either directly or by the purchase of nonredeemable securities, the principal and interest on which shall provide funds for the payment of any or all of the following:

(1) The principal of or purchase price of the bonds to be refunded by the refunding bonds.

(2) All expenses incident to the calling, retiring, purchasing, or paying of the outstanding bonds and the issuance of the refunding bonds, including any excess of the par value of the refunding bonds over the selling price thereof.

(3) Interest upon the refunding bonds from the date of sale to the date of payment of the bonds to be refunded, whether at maturity, pursuant to the call thereof or pursuant to any agreement with the holders thereof.

(4) Any premium necessary in the calling, retiring, or purchase of the outstanding bonds.

(5) The interest accruing on the outstanding bonds to the date of their call, retirement, or purchase.

(6) Subject to the limitation on those payments contained in subparagraph (A) of paragraph (2) of subdivision (d) of Section 16731, any termination payment owed by the state after offset for any payments made to the state pursuant to any hedging contract that was entered into in connection with the bonds to be refunded.

Refunding bonds may be exchanged at not less than their par value and accrued interest for outstanding bonds to be refunded thereby, and this chapter with respect to the sale of bonds does not apply to that exchange.

(b) Notwithstanding subdivision (a), the principal amount of any issue of refunding bonds shall not exceed the original aggregate principal amount of the series of bonds to be refunded. If there remains authorized but unissued bonds under the original bond act for the program which was funded by the series of bonds to be refunded, the principal amount of refunding bonds above the original aggregate principal amount of bonds to be refunded shall be charged against such unused authorization.

SEC. 8. Section 16784 of the Government Code is amended to read:

16784. The Refunding Escrow Fund is hereby created as a special fund in the State Treasury and is continuously appropriated for the purposes of this section. The proceeds of each sale of refunding bonds *and any other available moneys* shall be (1) set aside in a separate account within the Refunding Escrow Fund, (2) held in trust for the benefit of the holders of either or both of the bonds which are to be refunded or of the refunding bonds as provided in the resolution of the committee authorizing the issuance of the refunding bonds, (3) used only for the payment of the principal of, and interest and any redemption premium on, or the purchase price of the refunded bonds for the payment of interest on the refunding bonds up to the date of the redemption or payment of the bonds to be refunded, and (4) for the other purposes set forth in Section 16782. Moneys in each separate account shall be invested by the Treasurer in accordance with the resolution of the committee providing for the issuance of the refunding bonds, and any income from that investment shall be credited to the account from which the investment was made.

SEC. 9. This act is an urgency statute necessary for the immediate preservation of the public peace, health, or safety within the meaning of Article IV of the Constitution and shall go into immediate effect. The facts constituting the necessity are:

In order to provide for needed flexibility with respect to hedging contracts entered into by the state at the earliest possible time, it is necessary that this act take effect immediately.

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